No. 2957.

United States
Circuit Court of Appeals,

FOR THE NINTH CIRCUIT.

Wm. H. Moore, Jr., *Appellee,* *vs.* National Bank of Bakersfield, et al., *Appellants.*	A 32.
Wm. H. Moore, Jr., *Appellee,* *vs.* National Bank of Bakersfield, *Appellant.*	B 94.

BRIEF FOR APPELLEE.

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STATEMENT OF THE CASE.

This is an action brought by a trustee in bankruptcy to have declared void four chattel mortgages given by the bankrupt, Bannister, to the defendant bank; to declare possession taken thereunder illegal; and to recover from defendant the moneys received from the

sale of certain of said mortgaged goods, and other moneys paid to defendant by bankrupt.

The bill charges that two of said mortgages, each dated January 12, 1915, and covering the bankrupt's stock in trade of hay and grain and securing notes aggregating ten thousand five hundred dollars, all of which notes, except fifteen hundred dollars thereof, constituted antecedent debts, were void, (a) because they were on goods constituting stock in trade of a merchant; (b) because they were not recorded until April 23, 1915, a few days before bankruptcy, and not within a reasonable time after their execution; (c) because they constituted a preference under the Bankruptcy Act; and (d) because they were in fraud of creditors. The bill also charges that the two remaining chattel mortgages, one dated the 21st day of December, 1914, covering a corrugated iron warehouse building, and one dated the 5th day of January, 1915, covering an automobile, and each securing notes referred to in the "blanket mortgage" of January 12th, 1915 (one of the above-mentioned mortgages), were void because not recorded within a reasonable time, and because they constituted a preference, and were in fraud of creditors.

It was charged that all of said chattel mortgages constituted a preference in that at the time of their recordation Bannister was insolvent; that said mortgages were executed and recorded within four months prior to filing the petition in bankruptcy; that at the time of recordation defendant had reasonable cause to believe it was obtaining a preference, and that said mortgages operated to give defendant a larger proportion of its claim than other creditors of the same class.

It is also alleged that Bannister, between the 9th day of February, 1915, and the 25th day of June, 1915, sold the aforesaid stock in trade, the proceeds of which, together with other moneys, were paid to, and credited by said defendant upon said promissory notes; that at all times between the 9th day of February and the 25th day of June, 1915, Bannister was insolvent, and the said bank had reasonable cause to believe that said payments of money so received by it from the said bankrupt would effect a preference in its favor.

It is also alleged that said chattel mortgages were not recorded prior to the 23rd day of April, 1915, by reason of a secret agreement between the bankrupt, Alfred W. Bannister, and the defendant, National Bank of Bakersfield, to keep said documents from the record in order that Bannister's credit might not be impaired or destroyed, and with intent to prevent action being taken by the creditors of the said Bannister to collect their accounts against him, and that by virtue of said secret agreement said Bannister was given a false credit and financial standing whereby his creditors were induced to extend credit for merchandise purchased by him between the 12th day of January, 1915, and the 23rd day of April, 1915. It was prayed that all of said mortgages be declared null and void, and that an accounting be had of the moneys received by said bank, from said bankrupt and under said chattel mortgages, and that judgment be rendered against the bank in that amount.

An answer was filed by the defendant, in which it alleged that after the recordation of the mortgages on April 23rd, 1915, it took possession of the mortgaged

goods on said date; admitted the execution of the mortgages referred to in the bill of complaint, denied that on January 12th, 1915, and April 23rd, 1915, Bannister was insolvent, or that at the time either of the execution or the recordation of the chattel mortgages referred to, defendant had any cause to believe that the enforcement thereof would effect a preference in its favor, and sets out as an affirmative defense the fact that at various times prior to the 12th day of January, 1915, it had loaned Bannister sundry sums of money for the purpose of purchasing corn and grain, and in each instance had taken a chattel mortgage on the goods purchased by him, and that the corn and grain so purchased was placed in the warehouse and subsequently covered by the mortgage of January 12th, and undertook to claim an equitable lien on the mortgaged goods.

Subsequently, by leave of court first had, and with the consent of attorneys for defendant, complainant filed an amendment [Tr. 90] to his bill in equity which, as amended at the trial, charged that on the date Bannister was adjudicated a bankrupt, he had various creditors other than the defendant herein, many of whom had unsecured claims against him, and that the indebtedness in favor of said unsecured creditors was incurred by said bankrupt subsequent to the 12th day of January, and prior to the 23rd day of April, 1915, and that indebtednesses of certain other of said unsecured creditors were incurred by said bankrupt on dates prior to the 23rd day of April, 1915. Subsequently, an answer thereto was filed by defendant, and thereafter, pursuant to stipulation, at the time of trial

the amendment to the bill in equity was amended [Tr. 93] by the insertion of the words "unsecured" referred to in the transcript.

In reply thereto complainant contends:

That defendant did not take possession of the mortgaged goods until after the petition in bankruptcy was filed. That the chattel mortgages set forth in defendant's answer never have been recorded, were a secret lien, and are void; that with the knowledge of defendant the mortgaged goods were sold by bankrupt in the regular course of trade, and the mortgaged goods remaining were commingled and confused with other goods of the same character purchased by bankrupt, and that the goods, the possession of which was taken by defendant after the filing of the petition in bankruptcy, were goods constituting a portion of the mortgaged goods and other goods commingled therewith. That by reason of the foregoing facts a constructive fraud operates against said defendant and in favor of creditors of the bankrupt; that by reason thereof, and by reason of the fact that the mortgages referred to in the original bill are void as against creditors, that defendant's claim of an equitable lien is unsound.

The court, without findings, entered a decree against defendant adjudging each of said four mortgages void; that payments in the sum of one thousand dollars were made by said bankrupt between April 23rd and May 5th, 1915, on which last date the petition in bankruptcy was filed, and the said payment of one thousand dollars constituted a preference, within the terms of the Bankruptcy Act; and that subsequent to May 5th, 1915, defendant took possession of, and sold the undisposed

goods covered by the mortgages of January 12th, 1915, and other similar property commingled therewith, and received from the sale thereof $8,381.13, the reasonable value thereof; and further rendered judgment against said defendant for the sum of $9,381.13, with interest thereon at the rate of seven per cent per annum from July 10, 1915, the date of filing suit.

STATEMENT OF FACTS.

Alfred W. Bannister, for a long time prior to January, 1915, and until the 6th day of May, 1915, was a merchant, doing business in Bakersfield, engaged in buying and selling hay and grain. [Tr. 128, 132, 150, 235.] He carried his stock in trade in two warehouses, one at the so-called "Bannister Warehouse," in Bakersfield, and one at Wible Siding, near Bakersfield. [Tr. 149-150.]

Mr. Bannister was well acquainted with Mr. Russell, the cashier of the defendant bank, and when Mr. Russell became cashier of that bank in November of 1914, it was agreed between him and Bannister that the bank should loan Bannister money from time to time and take chattel mortgages on goods belonging to Bannister, which it should hold unrecorded until "something should happen" which would warrant the bank in recording them. [Tr. 131-132, 235-236, 241.]

It appears that in November, 1914, the bank loaned bankrupt the sum of twenty-five hundred dollars, taking a chattel mortgage, which was never recorded, on corn and hay on three ranches, securing a note in that sum dated November 11th, 1914. [Tr. 189, 236-237.]

It then loaned the sum of one thousand dollars, re-

ceiving a note dated December 1st, 1914, in the sum of one thousand dollars, secured by a chattel mortgage on fifty-five tons of Egyptian corn at the Bannister warehouse in Bakersfield, which mortgage was never recorded. [Tr. 190.]

It then loaned bankrupt the sum of fifteen hundred dollars, receiving a note dated December 9th, 1914, in said sum, secured by chattel mortgage on hay and grain situated on three ranches, and twenty tons of barley and twenty tons of corn at Bannister's warehouse in Bakersfield, which mortgage was never recorded. [Tr. 191.]

It then loaned Bannister on the 21st day of December, 1914, the sum of fifteen hundred dollars, taking on that day a note in the sum of fifteen hundred dollars secured by mortgage on corn and oats on two ranches, the corn and oat hay on a third ranch, which mortgage was never recorded. [Tr. 151-152.]

On the 4th day of January, 1915, it loaned bankrupt fifteen hundred dollars, taking a note in that amount on that date, secured by mortgage on sixty tons of corn, twenty tons of alfalfa hay, and fifty tons of barley hay at Bannister's warehouse, which mortgage was never recorded. [Tr. 192-193.]

On January 5th, 1915, it loaned bankrupt the sum of one thousand dollars, taking a note therefor in that sum, as of that date, secured by chattel mortgage, never recorded, on seventy tons of corn at Bannister's warehouse at Bakersfield. [Tr. 192-193.]

None of the aforesaid mortgages, as stated, were ever recorded. [Tr. 189-190-191-151-152-192-193.]

On the 21st day of December, 1914, bankrupt, as

additional security for the aforesaid note of December 21st, 1914, gave a chattel mortgage upon the corrugated iron warehouse building at Wible Siding [Tr. 152], and on January 5th, 1915 [Tr. 193], to secure the aforesaid note in the sum of one thousand dollars Bannister executed an additional mortgage upon a Stutz automobile. On January 12th, 1915, the bank loaned Bannister the additional sum of fifteen hundred dollars, taking a mortgage therefor on two hundred tons of grain hay located at Bannister's warehouse at Wible Siding [Tr. 150], and on the same date, to-wit, January 12th, 1915, to secure all the aforesaid notes, Bannister made a blanket mortgage on all the hay and grain in both the Bannister and Wible warehouses, constituting practically all his then stock in trade, the amount thereof being particularly described in said mortgage, and covering all that then remained of the original goods covered by the previous unsecured chattel mortgages. [Tr. 150, 181, 202.]

None of the mortgages were ever recorded except the two mortgages of date January 12th, 1915, and the two mortgages covering the Stutz automobile and the corrugated iron warehouse, which were not recorded until April 23rd, 1915. [Tr. 150, 152, 193, 187.]

It is conceded and undisputed that the blanket mortgage covered the stock in trade of a merchant. [Tr. 180, 185.] At the time the different mortgages were made the possession was in Bannister, and there was no delivery of the goods covered by the different mortgages, and no actual or constructive change of possession thereof until after the petition in bankruptcy was filed on the 5th day of May, 1915. [Tr. 139, 140,

164, 165, 173, 175, 179, 196-203, 213, 219.] Bannister was constantly selling the goods covered by the chattel mortgages and replacing the same by new goods purchased, and continually sold goods therefrom in the ordinary course of business, and confused the remaining mortgaged goods with the new goods purchased and substituted in lieu of the goods sold from the mortgaged stock. [Tr. 149, 171-172, 177, 178, 179, 188, 194, 195, 196, 202, 205, 206, 249, 252.] The officials of the bank at various times after January 12th, 1915, and prior to April 23rd, 1915, examined Bannister's books and were conversant with his method of doing business, and knew that he was selling the mortgaged goods in the ordinary course of business. [Tr. 172, 238, 246.] The bank made no protest, but rather acquiesced in this method of business, and throughout the entire interim retained the chattel mortgages in its vault, where they were first placed after their execution. [Tr. 172, 233, 238, 240, 252.] The creditors were never notified of the existence of the chattel mortgages and the creditors examined stated that they never knew of the existence thereof. [Tr. 153, 230, 231, 246, 247.] The result was that Bannister obtained a credit to which he would not have been entitled had the creditors known of the existence of the chattel mortgages.

On April 21st, 1915, Bannister's home in Los Angeles was attached [Tr. 164], and Bannister says that immediately thereafter he notified Mr. Russell of that fact. [Tr. 131, 164.] Mr. Russell, the bank's cashier, states that on April 23rd, 1915, before recording the chattel mortgages, he met a man on the street who told

him that Bannister was in financial trouble; that while he did not know what the trouble was, that inasmuch as they had spoken to him about it, he went back to the bank, got the mortgages, and recorded them, first telling his assistant cashier that he was going to record them and that by recording them, "if something should happen" he could take possession and protect his money. [Tr. 241.] When Bannister returned from Los Angeles, Russell told him that he had heard that he was in difficulties down there, and that he had recorded all the mortgages, to which Bannister responded, "All right; it belongs to you, that was the agreement." [Tr. 241, 242.]

The petition in bankruptcy was filed May 5th, 1915. [Tr. 165.] The bank did not take possession under its chattel mortgage until May 6th, 1915. The bank received after April 23rd, 1915, the sum of $9,881.13, of which $500 was paid May 4th, $500 May 5th, and the balance thereof on May 6th and subsequent thereto, and the entire $9,881.13 was received from the proceeds of the sale of a portion of the mortgaged hay and grain, and other hay and grain commingled therewith in lieu of that sold in the ordinary course of business. [Tr. 249.] As said property was sold subsequent to the filing of the petition in bankruptcy the proceeds thereof were placed to Bannister's credit and checks were given by him to the bank in the aforesaid amounts. [Tr. 170.]

Such being the facts, we contend:

First: That all preliminary unrecorded mortgages

referred to in defendant's answer are each void because never recorded;

Second: That the two mortgages of date January 12th, 1915, one of them being the "blanket mortgage," and both being on hay and grain, were void for the following reasons:

(a) Because they were on goods constituting the stock in trade of a merchant;

(b) Because they were not recorded within a reasonable time:

(c) Because no possession was taken thereunder prior to the institution of bankruptcy proceedings, and the pretended possession was void under section 3440 of the Civil Code of California;

(d) Because, with the exception of one note dated January 12th, 1915, they were given to secure an antecedent indebtedness; and because they constituted a secret lien; and the bankrupt conducted his business during the interim prior to recordation in his ordinary manner, selling from the mortgaged goods, and buying other goods which he substituted in lieu of that sold, all with the knowledge of the defendant, thus creating a constructive fraud as against creditors;

(e) That all of the four mortgages recorded April 23rd, 1915, operated as a preference, in that at the date of their recordation the bankrupt was insolvent, the defendant had reasonable cause to believe that by recording the mortgages it would obtain a preference, and the effect thereof was to give to defendant a larger percentage of its claim than other creditors of the same class.

Third: That even prior to the amendment of the

Bankruptcy Act of 1910, the trustee had the right to set aside transactions constructively fraudulent, and preferences given by the bankrupt; since which time, by the amendment to 47a of the Bankruptcy Act, as construed by the courts, as to all property not in the custody of the bankruptcy court the trustee is vested with all the rights, remedies and powers of a potential judgment creditor holding an execution duly returned unsatisfied, and that at the time of filing the petition in bankruptcy on May 5th, 1915, under the laws of California, a judgment creditor might have maintained an action to set aside the mortgages on the ground that they were not recorded within a reasonable time, and because some of them were on stock in trade of a merchant.

On the other hand, it is now contended by the defendant:

First: That there is no showing in the record as to the amount of proven claims in this estate, and

Second: That the evidence does not show that at the time of recordation the bank had reasonable cause to believe that such recordation would give them a preference;

Third: That it had an equitable lien, arising out of the fact that the bank also held prior mortgages, void because not recorded, securing all the notes but one covered by the blanket mortgage.

To which we respond:

First: That the law does not require that the trustee either aver or prove the amount of proven claims, and that the evidence establishes the fact that to permit

defendant to retain possession of moneys received by it will permit it to receive a larger percentage of its debts than other creditors of the same class;

Second: That the evidence conclusively shows that just prior to the recordation of the mortgages, defendant had reasonable cause to believe that it would obtain a preference by such recordation;

Third: No equitable lien can be found. An equitable lien will not be found in favor of one guilty of a constructive fraud. It cannot be established, on goods confused with other goods with consent of the bank, by the bankrupt. Neither can it be established since rights of creditors intervene, and as to such creditors it is void.

I.

The Two Chattel Mortgages Dated January 12th, 1915, One of Them Being the "Blanket Mortgage," Were Void Because They Covered the Stock in Trade of a Merchant in Contravention of Section 2955 of the Civil Code of California.

No Actual Possession Was Taken Thereunder, and the Pretended Possession, Contended for by Defendant, Was Void Under Section 3440 of the Civil Code Because the Alleged Lien or Transfer Was Given or Made by the Bankrupt While in Possession and Control of the Property and Was Not Accompanied by Immediate Delivery, Followed by an Actual and Continued Change of Possession; and

Even Assuming Actual Possession Taken, No Notice of the Intended Transfer Was Recorded in the Office of the County Recorder, as Provided for by Section 3440 (supra).

Bannister was a merchant, engaged in the business of buying and selling hay and grain. He was so described in his bills and letterheads and in some of the mortgages in evidence. [Tr. 128, 150, 152.] His stock in trade was in the Bannister warehouse and the warehouse at Wible Siding. [Tr. 150.] Indeed, it was admitted by counsel at the time of the trial that this merchandise constituted stock in trade of a merchant. [Tr. 180 and 185.]

Section 2955 of the Civil Code provides:

"Mortgages may be made upon all growing crops, including grapes and fruit, and upon any and all kinds of personal property, except the following: * * * 3. The stock in trade of a merchant."

Prior to the amendment of the Civil Code of 1909, section 2955 provided as follows: "Mortgages may be made upon the following personal property, and no others"; and then follows a list of personal property upon which mortgages might be made.

It has been held under this section that where the chattel mortgage is upon articles which may not be mortgaged, that even the recordation thereof imparts no constructive notice to the world. In the case of Bank of Ukiah v. Moore, 106 Cal. 679, it is said:

"It will be observed that the foregoing statement that while the complaint avers the execution and recording of the mortgage as provided for, by sections 2955 and 2957 of the Civil Code, in cases of mortgages on personal property, yet the articles mortgaged—sheep and neat cattle—were not among the articles provided to be mortgaged under said section 2955.

"It follows that the mortgage was not one the recording of which imparted constructive notice to the world. * * *

"The theory of appellant, however, presupposes a valid instrument to record, and in the present instance the objection is, there was no valid statutory mortgage to be recorded, and as the statute provides for recording only those which may be made pursuant to section 2955, and in the manner designated in section 2957, the record could impart no constructive notice."

And it is the law of this state that such a mortgage is invalid as against creditors of the mortgagor.

Bank of Ukiah v. Moore, 106 Cal. 680;

Perkins v. Maier & Zobelein Brewing Co., 133 Cal. 498.

Defendant in its answer claims possession was taken immediately after the recordation of the mortgage on April 23rd, but it does not establish this contention by evidence. On the contrary it appears that possession was not taken until subsequent to the filing of the petition in bankruptcy on May 5th. Mr. Russell, the bank's cashier, testified that in addition to recording the mortgages on the 23rd day of April, he made arrangements with Miss Fitzpatrick to go to the Bannister warehouse at Bakersfield the next morning and look out for all the stuff that went out of there, and that he told her to keep a clear record of everything that came in and went out. That she reported daily to him and he paid her for doing the work, but she did not pay over to him the cash received from the office. [Tr. 242.] Miss Fitzpatrick was then, and had been for a long time prior thereto, acting as a stenographer for the bankrupt, Bannister, receiving fifty dollars a month for her services. [Tr. 196 to 201, inclusive.] It affirmatively appears from the evidence that after April 24th, other help at the warehouse was paid out of the receipts of the warehouse, and the balance of the money was credited to Bannister's account at the bank. [Tr. 197, 201, 250.] At no time prior to the filing of the petition in bankruptcy was there any visible change of possession. No signs were placed on the building in-

dicating such change of possession, and it does not appear that any markings, labels, or tags were placed upon any of the mortgaged property indicating that the bank was in possession thereof. [Tr. 198, 199.] The employees of the bankrupt remained the same and were paid the same, and by the bankrupt's check. [Tr. 186, 197, 203, 242.] Bannister, upon his return from Los Angeles on April 24th, continued working on the place and in possession, control and custody of the warehouse and of the proceeds thereof, and to outward appearances continued to conduct the business until May 6th, 1915. [Tr. 196, 202, 206, 219, 242.] No change was made in the use of Bannister's letterheads prior to May 6th. [Tr. 128.] Bannister himself testified that he continued in possession down to the filing of the petition on May 5th, 1915. [Tr. 165.] Bannister further testified that the shipping receipts would show the shipments made by the bank after May 4th, 1915. [Tr. 173.] The shipping receipts show the shipments were made by Bannister April 24th, April 27th, May 3rd, 4th and 5th, and that the first shipment made by the bank after the recordation of the mortgages was made on May 6th, 1915. [Tr. 212, 213.] Bannister's ledger shows an account opened with the National Bank of Bakersfield as of date May 6th. [Tr. 175.] It is also significant that Russell testified that the bank received $8,881.13 from the sale of the mortgaged hay and grain. [Tr. 249.] The date of the different payments made to the bank appears on page 244 of the transcript. Had possession been taken by the bank on April 24th, the bank would have received $9,381.13

from the sale of the mortgaged hay and grain instead of the sum testified to by Mr. Russell.

It is the settled law of this state that possession, to be valid, must be open, visible, and of such a character as to give notice to the world that there has been a change of possession in order that creditors may be bound thereby.

Center v. Kelton, 20 Cal. App. 612;
George v. Pierce, 123 Cal. 172;
Lilienthal v. Ballou, 125 Cal. 185;
Sequeira v. Collins, 153 Cal. 426;
Ross v. Thomas, 24 Cal. App. 734.

It is conclusively established, therefore, that under the facts and the law of this state, no possession was taken by the bank prior to May 6th, and subsequent to the filing of the petition in bankruptcy.

However, assuming, for the sake of argument, that such constructive possession was taken as contended for by defendant, prior to the filing of the petition in bankruptcy, such possession is void, under section 3440 of the Civil Code, for the reason that the alleged transfer was made by the bankrupt while in possession and control of the property, and was not accompanied by an immediate delivery, followed by an actual and continued change of possession; and even if we assume actual possession taken, no notice of the intended transfer was recorded in the office of the county recorder as required by section 3440 of the Civil Code.

Section 3440 provides:

"Every transfer of personal property, * * * and every lien thereon, other than a mortgage,

when allowed by law, * * * is conclusively presumed, if made by a person having at the time the possession or control of the property, and not accompanied by an immediate delivery, and followed by an actual and continued change of possession of the things transferred, to be fraudulent, and therefore void, against those who are his creditors while he remains in possession, and the successors in interest of such creditors, and against any persons on whom his estate devolves in trust for the benefit of others than himself, and against purchasers or encumbrancers in good faith subsequent to the transfer; * * *

"And provided, also, that the sale, transfer, or assignment of a stock in trade (or of such a quantity of a stock in trade as to be substantially a whole) in bulk, or in any manner otherwise than in the ordinary course of trade and in the regular and usual practice and method of business of the vendor, against the existing creditors of the vendor, transferrer, or assignor, unless at least five days before the consummation of such sale, transfer, or assignment the vendor, transferrer, or assignor, or the intended vendee, transferee, or assignee shall record in the office of the county recorder in the county or counties in which the said stock in trade is situated, a notice of said intended sale, transfer, or assignment. * * *"

Neither, at the time of the execution or recordation of the chattel mortgages, was there any immediate delivery, followed by actual and continued change of possession.

The first portion of section 3440 quoted is applicable because the mortgages referred to, being on the stock in trade of a merchant, were not allowed by law, and

therefore any lien which the mortgages might have created as between the parties, because not accompanied by an immediate delivery and followed by an actual and continuous change of possession, was conclusively presumed to be fraudulent and void as against creditors.

Furthermore, the transfer was upon the stock in trade of a merchant, in bulk, and not in the ordinary course of trade and in the usual method of business of the vendor, and the record fails to show, as required by the statute, that five days before the consummation of such transfer, a notice of said transfer was recorded in the office of the county recorder. In fact, the evidence on the subject negatives such notice. [Tr. p. 177.] So, assuming actual possession taken, such possession was fraudulent as to creditors then existing.

II.

The Aforesaid Two Chattel Mortgages, Dated January 12, 1915, One of Them Being the "Blanket" Mortgage, Together With the Mortgages on the Automobile and the Warehouse, Are Also Void Because Not Recorded Within a Reasonable Time After Their Execution.

Under the Laws of California It Is Not Necessary That Such Creditors Should Have Attached or Obtained a Judgment Lien Before the Recordation of the Mortgages in Order That They Be Permitted to Take Advantage of the Invalidity Thereof. The Trustee Has All the Rights of a Potential Judgment Creditor (Whether or Not Such a Judgment Creditor Did in Fact Exist) as of the Date of the Filing of the Petion in Bankruptcy.

During the interim between the execution and the recordation of the mortgages the bankrupt incurred a large amount of indebtedness, the dates of incurring some of which is set forth in the schedules in bankruptcy. [Tr. p. 156.] He also incurred a large amount of indebtedness prior to making the mortgages. [Tr. p. 156.] The creditors extending credit between the execution and recordation of the mortgages were all unsecured. The mortgages, upon execution, were placed in the safety deposit vault of defendant bank and no notice thereof was given by the bank to other creditors.

The mortgages recorded April 23rd, 1915, were made on the following dates:

One dated December 21st, 1914, on a corrugated iron and frame warehouse, located at Wible Siding. Kern county, California; one dated January 5th, 1915, on a Stutz automobile; and two dated January 12th, 1915, on stock in trade.

Under the laws of California a chattel mortgage not recorded within a reasonable time after the execution thereof is void as to creditors of the mortgagor. Section 2957 of the Civil Code provides:

> "A mortgage of personal property is void as against creditors of the mortgagor and subsequent purchasers and encumbrancers of the property in good faith and for value, unless:
>
> "1. It is accompanied by the affidavit of all the parties thereto that it is made in good faith and without any design to hinder, delay, or defraud creditors;
>
> "2. It is acknowledged or proved, certified, and recorded in like manner as grants of real property."

The doctrine stated has been applied in this state in Ruggles v. Cannedy, 127 Cal. 291. In that case the creditors were created intermediate the execution and recordation of the mortgage. The reasoning of the court, however, would result in the application of the doctrine to any creditors, whether such creditors were created before or after the execution of the mortgage. The mortgage there made was not recorded until six months after its execution, and two days before the maker, under his voluntary petition, was declared an insolvent. Intermediate the time of giving and the time of recording the mortgage, Wilgus, the maker,

incurred debts, some of which were proven and allowed in the insolvency court. The creditors knew nothing of the mortgage until its recordation. The court held that a chattel mortgage withheld from record beyond a reasonable time necessary for its recordation is void against creditors, basing its decision upon the ground that the recordation of a chattel mortgage, pursuant to section 2957 of the Civil Code, is intended to take the place of immediate delivery and change of possession of personal property essential to effect transfers of personal property in other cases under section 3440 of the Civil Code. That prior to the enactment of section 2957 a chattel mortgage, to be valid, must have been followed by immediate change of possession, and that section 2957, requiring recordation, simply substituted such recordation in place of the immediate change of possession previously required, and that therefore such recordation must be made immediately, or at least within a reasonable time. And the court further held that it was not necessary that the creditors should have attached or obtained judgment prior to recordation in order that they might object to the validity of the chattel mortgage; that it was only necessary that the creditor, as a preliminary step to bringing suit, should reduce his claim to judgment, and that this might be done at any time before suit instituted. The court says:

> "But here it is argued that, while the law makes recordation the substitute for an immediate delivery, it does not mean or require immediate recordation, but only provides that, when effected, recordation is the equivalent of immediate delivery and continued an actual change of possession.

Considering that the law demands immediate delivery, and that recordation is but a substitute for it, it is not easy to see how an indefinitely delayed recordation may be said to take the place of an actual, immediate delivery. One being designed as a substitute for the other, what is the condition, in the one case, if the property be not immediately delivered? Indisputably, the mortgage is void as to creditors. What, then, is the condition in the other case for the indefinite period during which there has been no recordation? While recordation is lacking there is not only no equivalent for an immediate delivery, but there is no delivery at all. Recordation itself is the substitute for delivery.

"A prompt recordation most obviously takes the place of an immediate delivery, and a delayed recordation of a tardy delivery. Now, then, can a recordation effected one year or ten years after the execution of the mortgage be said to be the equivalent of the delivery which by the law is required to be made with all reasonable dispatch? Even more untenable does this argument seem when consideration is had for the manifest policy of these laws. The very object of them all, the reason for their being, is to prevent secret liens upon and interests in personal property." * * *

"With this for the unquestioned policy of the law, how can it successfully be urged that an interpretation which fosters and encourages the very evil which the law was designed to check can be the true one? A mortgage without immediate delivery would create a secret lien, admittedly void against creditors. Is a mortgage without immediate recordation any less a secret lien, or any less an evil to be avoided. Prior to the amendment to section 2955 of the Civil Code, adopted in 1895,

as counsel well instance, if a person had desired to borrow money upon his farming implements he would have been compelled to transfer possession immediately under section 3440 of the Civil Code. By the amendment these implements are placed in the list of those upon which statutory chattel mortgages may be given. Therefore, he may now make such a mortgage upon them without delivery. Did the legislature intend to accommodate the farmer by enabling him to retain possession and use of his property, while at the same time protecting the public by recordation? Or did it design to make fraud easier by framing an ever-increasing list of articles upon which might be placed secret liens? The mortgagor holding possession could thus obtain credit upon the strength of his apparent untrammeled ownership, while the mortgagee could defeat the creditors' recovery by recording his mortgage at any time before the levy of an attachment. * * *

"We conclude upon this question that our law requires immediate recordation in lieu of immediate delivery, and that when such recordation is not effected the mortgage 'is void as against creditors of the mortgagor.' The penalty for a failure to record promptly in the case of a mortgage is identical with the penalty under section 3440 for a failure to delivery promptly in the case of a sale. In either case the failure *results* in a *legal fraud* against those whom the statute enumerates and protects. Section 3440 excepts a 'mortgage when allowed by law' from the requirement of immediate delivery, because, and only because, the recordation takes the place of delivery. It certainly cannot be said that it was the design of the legislature to exclude the articles of personal property affected

by such mortgages from the operations of the laws forbidding secret liens." * * *

"But it is insisted that, even if an unrecorded mortgage is void at the instance of creditors, only those creditors may take advantage of the law who by judgment and execution levy, or at least by attachment levy, have acquired a lien upon the property before recordation. * * *

"To this the answer is that such is not the law of this state. In terms, this rule is limited to those cases where immediate recordation is not required by law, and in our state, as has been discussed, as well as in other states under similar and well-nigh identical statutes, as will be shown, immediate recordation is exacted. Again, as we have seen, a perfect analogy exists in our law between the case of sales and the case of mortgages of personal property. In both, immediate delivery, or its equivalent—immediate recordation—must take place. In each the result of a failure in this particular is to render the contract absolutely void as to creditors. In Watson v. Rodgers, 53 Cal. 402, it is held that a sale of personal property unaccompanied by an immediate delivery is void as to creditors, notwithstanding the delivery was effected before the creditors acquired a lien by attachment levy. In Chenry v. Palmer, *supra,* it is decided that, whether the contract is a sale or a mortgage, in either event, not being followed by immediate delivery, it was void as to creditors, though delivery was made before levy. In other words, two distinct propositions have thus been decided. 1. *That neither in the case of a sale nor of a mortgage would a delayed delivery validate the contract against creditors; and 2. That it was not necessary that these creditors should have acquired*

rights by judgment or attachment before delivery of the chattel sold or mortgaged to warrant their setting aside the transfer. Our recordation laws, admittedly being but a substitute for such immediate delivery, certainly have not changed the principles here announced, and should not be said to have changed the rule which elsewhere finds abundant support." (Italics ours.)

The doctrine of Ruggles v. Cannedy was followed in the case of Hopper v. Keys, 92 Pac. 1019, 152 Cal. 488, which was an action under section 2965 of the Civil Code, providing that when mortgaged personal property was removed from the county it is exempt from the operation of the mortgage unless the mortgagee, within thirty days, causes the mortgage to be recorded in the county to which the property has been removed. It was held that unless the mortgage was again recorded in the county to which the property was removed within thirty days after the removal the mortgage was void as to creditors. The court saying:

"And it may here be stated that in an elaborate and signally able opinion by Justice Henshaw in Ruggles v. Cannedy, *supra,* it is held that the recordation of the mortgage, having been designed by the statute as a substitute for and equivalent of immediate possession under the former system in vogue in this state, should be had immediately, or as near thereafter as practicable, upon the execution of the mortgage, in order to give notice to and bind third parties. It must be conceded that the authority for the creation of chattel mortgages in this state derives its force from the statutory provisions relating to the subject, and that all rights accruing by virtue of such mortgages

can be protected and preserved only by fully meeting the requirements of the statute and strictly observing its provisions. That the recordation of the mortgage, under our present system, is one of the necessary and indispensable requisites to protect the rights of the mortgagee against creditors of the mortgagor and subsequent purchasers and incumbrancers of the property in good faith and for value, is a self-evident proposition. 'It must be remembered, in general, that the policy of the law is against secret liens and charges to injury of innocent purchasers or incumbrancers for value, and in particular that mortgages of personal property are permitted only in certain specified cases, and then only upon the observance of certain formalities, designed to insure good faith, and to give notice to the world of the character of the transaction.' * * * The recordation of the mortgage after the time prescribed by the statute could not have the effect of reviving the mortgage so as to render it operative against the creditors of the mortgagor, because there is no provision in the statute which provides that any such power rests in such act of recordation. * * * The reason upon which rests our whole system of chattel mortgages, as it now exists and was established by our legislature in lieu of the former system in this state, satisfactorily and conclusively answers the question. The law is designed to protect the rights of all classes. It plainly and clearly points the way to the mortgagee for the protection of these rights. But he is by the law chargeable with vigilance, and will not be permitted to sleep upon his rights. He must watch, follow, and pursue the safeguards accorded him by the law."

In Watson v. Rodgers, 53 Cal. 401, it is held that the sale of personal property, unaccompanied by immediate delivery and continued change of possession which is required by section 3440 of the Civil Code, is void as to creditors, notwithstanding the fact that the vendee obtains possession before the levy made by the creditor.

In the case of Cardenas v. Miller, 108 Cal. 252, the court says:

> "Our statute makes a very plain distinction between creditors and subsequent purchasers and mortgagees. The latter are protected against the prior unrecorded mortgage only when they take their conveyances 'in good faith and for value'; and, of course, they do not take them in good faith if they have actual notice of the prior mortgage. But not so as to creditors. As to them good faith is not made a condition, but such a mortgage is declared void without qualification. As to them the question of actual notice is made wholly immaterial under the statute, and, consequently, knowledge on their part of the existence of such unrecorded mortgage will not protect its holder against their claims. The plain import of the statute is that nothing but a compliance with its terms will protect a mortgage of chattels against creditors. This construction is in accord with that given to the statutes of a number of other states wherein a similar distinction is made in the law between creditors and subsequent purchasers and mortgagees."

The Supreme Court of the state, in Ruggles v. Cannedy, *supra*, in support of the foregoing doctrine, cites decisions of various states, among them that of Karst

v. Gane, 136 N. Y. 316. And that case finds further approval in *In re* Mission Fixture & Mantel Co., 180 Fed. 263, decided by District Judge Donworth for the Northern District of Washington, where, in construing the Washington statute requiring the recordation of chattel mortgages, it is said:

> "This language, I think, means that a person is to be deemed a creditor within the contemplation of the statute from the time when the debtor becomes obligated to him, and, if that is its meaning, an unrecorded mortgage is void as to one who holds an obligation against the mortgagor, though the inception of the obligation antedated the making of the mortgage."

In Karst v. Gane, *supra,* the New York Supreme Court says:

> "The first section declares that a mortgage of chattels which shall not be accompanied by an immediate delivery, and an actual and continued change of possession, of the things mortgaged, 'shall be absolutely void as against the creditors of the mortgagor, and as against subsequent purchasers and mortgagees in good faith, unless the mortgage, or a true copy thereof, shall be filed as directed in the succeeding section of the act.' There is nothing in the language of the section confining the meaning of the word 'creditors,' or restricting its natural sense, or which indicates an intention to distinguish between a creditor who became such before, and one who became a creditor after, the execution of the mortgage."

It is thus the law of this state that the recordation of the mortgage, having been designed by the statute

as a substitute for the immediate possession under the former system in vogue in this state should be effected immediately, or as soon thereafter as practicable. That it is the purpose of the law to declare fraudulent all transfers of personal property when not accompanied by immediate change of possession, except only where a chattel mortgage has been made upon the property contemplated by the law, with an immediate notice thereof by recordation, in lieu of such change of possession, and where a chattel mortgage is not immediately recorded it is void as to creditors.

It is also the law in this state that it is not necessary that the creditors, before the recordation of the mortgage, shall have obtained a judgment against the debtor. It is only necessary that the creditor, before in fact instituting the suit himself, shall have perfected his lien to such an extent as to permit him to file a creditor's bill. Consequently, if, on May 5th, 1915, the date the petition in bankruptcy was filed, any of the bankrupt's creditors had obtained a judgment they would have been entitled to have maintained thereafter a suit to set aside these mortgages.

The rationale of the foregoing rule, declared in Ruggles v. Cannedy, is well stated in Union National Bank v. Oium (N. D.), 54 N. W. 1034, where the court says:

> "It is important that there should be kept in mind a distinction between the right of a general creditor to insist that an unfiled chattel mortgage is void and the ability to enforce this right. While an unfiled chattel mortgage may be void as to a general creditor, he cannot avail himself of the

statute until he has armed himself with attachment or execution and levied on the property, or has in some other way secured a lien thereon. Before he has seized the property covered by the chattel mortgage, or secured some lien thereon, he is in no position to raise the question that the mortgage is void as to him. * * * The statute does not, however, require that he should be armed with process or have a lien on the property to entitle him to come within the category of 'creditors,' as to whom the unfiled instrument is a nullity. The mortgage is not void as to creditors who have seized the property, or who hold process under which they can seize it. This is not the language of the statute. The mortgage is void as to creditors, and nothing is said in the statute about the necessity of a creditor's having secured a lien on the mortgaged property. The fact that the creditor cannot assail the mortgage until he has seized the property is of no moment in determining whether he belongs to the class of persons as to whom the mortgage is void.

A trustee in bankruptcy, under section 47a of the Bankruptcy Act as amended in 1910, has all the rights of a potential judgment creditor; that is to say, he has all the rights that a judgment creditor might have had had the judgment creditor existed on May 5th, 1915, even though that judgment creditor did not, in fact, exist at that time.

Prior to the amendment of 1910 it was the law that the trustee stood in the place of the bankrupt, and in the absence of fraud possessed no greater rights than the bankrupt, and did not have the rights inuring to a creditor. This situation was remedied by the amend-

ment of 1910 to section 47a of the Bankruptcy Act, which provides:

> "And such trustee, as to all property in the custody, or coming into the custody of the bankruptcy court, shall be deemed vested with all the rights, remedies and powers of a creditor holding a lien by legal or equitable proceedings thereon; and also as to all property not in the custody of the bankruptcy court, shall be deemed vested with all the rights, remedies and powers of a judgment creditor holding an execution, duly returned unsatisfied."

Since this amendment decisions holding that a trustee has no greater rights than those belonging to the bankrupt are no longer controlling. The trustee now has all the rights, remedies, and powers that a judgment creditor, holding an execution returned unsatisfied, might have had, and this even though there were no judgment creditors of the bankrupt at the time of instituting the proceedings in bankruptcy. Such is the law in this circuit.

Pacific State Bank v. Coats, 205 Fed. 618 (C. C. A., 9th Cir.);
Scandinavian-American Bank v. Sabin, 227 Fed. 581 (9th Cir.);
In re Mission Fixture & Mantel Co., 180 Fed. 263.

See also:

In re Pittsburg-Big Muddy Coal Co. (C. C. A., 7th Cir.), 215 Fed. 705;
Interstate Banking & Trust Co. v. Brown (C. C. A., 6th Cir.), 235 Fed. 32;

In re Johnson, 212 Fed. 311;

Gerstman v. Bandman, 157 Fed. 549 (C. C. A., 2nd Cir.);

In re Bothe, 173 Fed. 597 (C. C. A., 8th Cir.);

Post v. Berry, 175 Fed. 564 (C. C. A., 8th Cir.);

Simmons v. Greer, 174 Fed. 654 (C. C. A., 4th Cir.);

Smith v. Mishawaka Woolen Mfg. Co., 172 Fed. 98 (C. C. A., 7th Cir.);

In the Matter of Watts-Woodward Press, 181 Fed. 71 (C. C. A., 2nd Cir.);

In re Beede, 126 Fed. 853;

In re Palmer, 218 Fed. 74;

Bailey v. Baker Ice Machine Co., 239 U. S. 268, 36 Sup. Ct. Rep. 50;

Potter Mfg. Co. v. Arthur, 220 Fed. 845 (C. C. A., 6th Cir.);

In re Gehris-Herbine Co., 188 Fed. 502;

In re Kessler, 186 Fed. 127 (C. C. A., 2nd Cir.);

In re Smith, 198 Fed. 876;

Sattler v. Slonimsky, 199 Fed. 592;

In re Whatley Bros., 199 Fed. 326;

In re Bazemore, 189 Fed. 236;

In re Calhoun Supply Co., 189 Fed. 537.

In the case of Pacific State Bank v. Coats, *supra,* this court, speaking through Judge Wolverton, says:

> "Is the trustee in bankruptcy in a position to controvert the validity of the mortgage either as a real or chattel mortgage? It is insisted on the part of the bank that, because the trustee represents only creditors who became such after the

date of giving the mortgage, he cannot question the validity of such mortgage. The bankruptcy statute provides that:

" 'Such trustees, as to all property in the custody or coming into the custody of the bankruptcy court, shall be deemed vested with all the rights, remedies, and powers of a creditor holding a lien by legal or equitable proceedings thereon; and also, as to all property not in the custody of the bankruptcy court, shall be deemed vested with all the rights, remedies, and powers of a judgment creditor holding an execution duly returned unsatisfied.'

"This is an amendment to section 47, cl. 2, sub. 'a,' adopted June 25, 1910, ch. 412, Sec. 8, 36 Stat. 840 (U. S. Comp. St. Supp. 1911, p. 1500). It is the purpose of this amendment to vest in the trustee for the interest of all creditors the *potential rights of creditors* possessing or holding liens upon the property coming into his custody by legal or equitable proceedings. The trustee no longer stands in the shoes merely of the bankrupt, with the limited rights of the bankrupt to attack unrecorded liens which may be valid and unimpeachable by such bankrupt; but the amendment by operation of law vests in him a lien equivalent to such as would be acquired by legal or equitable proceedings upon the property coming into his custody by virtue of the bankruptcy proceedings. 'The class of cases, unprovided for by the original act, and intended to be reached by the amendment,' says Mr. Collier in his work on Bankruptcy (9th Ed.), p. 659, 'was that in which no creditors had acquired liens by legal or equitable proceedings and to vest in the trustee for the interest of all creditors the potential rights of creditors poten-

tial with such liens.' 'This provision of the Bankruptcy Act,' says Witner, judge, *In re* Hartdagen (D. C.), 189 Fed. 546, 549, 26 Am. Bankr. Rep. 532, 535, 'puts the trustee, in so far as the assets of the estate are concerned, in the position of a lien creditor,' distinguishing the case of York Mfg. Co. v. Cassell, 201 U. S. 344, 26 Sup. Ct. 481, 50 L. Ed. 782, and others of its character, which it is thought inspired the amendment."

Scandinavian-American Bank v. Sabin, *supra,* where this court states:

"To the contention of the appellant that the trustee is without authority to maintain the proceeding, for the reason that no creditor has secured a lien upon the goods at the time the bank took possession of them, and hence the trustee secured no greater rights than the bankrupt himself had, it is only necessary to state that section 8 of the Act of June 25, 1910, amending section 47 of clause 2 of the Act of 1898 (36 Stat. 840), provides that the trustee, 'as to all property in the custody * * * of the bankruptcy court, shall be deemed vested with all rights, remedies, and powers of a creditor holding a lien by legal or equitable proceedings thereon.' Under this provision of the statute the trustee is not limited to such objections to a transaction between the bankrupt and a creditor as the bankrupt might have had, but he may make any objection that a creditor holding a lien might make. An agreement, therefore, which prior to this amendment would have been valid between the parties, may not be valid as against the trustee. Meier & Frank Co. v. Sabin, 214 Fed. 231, 233, 130 C. C. A. 605."

In re Pittsburg-Big Muddy Coal Co. (C. C. A. 7th Cir.), 215 Fed. 705, the court, through Circuit Judge Baker, says:

"But we hold that under the amendment the filing of a petition in bankruptcy constitutes an equitable levy and a caveat to the world, for the following reasons: (1) The plain and natural reading of the words gives the trustee the same right to attack or resist secret liens that judgment creditors would have had if bankruptcy had not intervened, no matter whether there are or are not any such creditors when the petition in bankruptcy is filed. (2) If the amendment were to be construed so as to limit the power of the trustee to cases in which there are lien creditors, virtually nothing would be added to the original act, for under section 67c and 67f liens created within four months prior to the filing of the petition may be used by the trustee for the benefit of the estate. (3) Although extraneous matter cannot properly be looked to in aid of the interpretation of a clear and unambiguous statute (for such a statute carries its own means of interpretation), yet it may not be amiss, as against a contention that this amendment is not unambiguous, to note that it was the intention of the committee in charge of the measure that the rule announced in York Mfg. Co. v. Cassell should be changed. 3 Remington 331; Cong. Rec., 61st Cong., 2d Sess., pp. 2552-2554. (4) Numerous decisions in the District and Appellate Courts directly or impliedly support this construction."

In Interstate Banking & Trust Co. v. Brown, 235 Fed. 35 (C. C. A., 6th Cir.), the court says:

"By virtue of the amendment of June, 1910,

to section 47a (2) of the Bankruptcy Act, this trustee represents creditors not secured by receipts with the same force and effect as if these unsecured creditors had, on April 26th, levied executions upon the cotton in the warehouse."

In the case of Bailey v. Baker Ice Machine Company, 239 U. S. 268, the Supreme Court of the United States, in determining the time that the trustee took the status of a creditor holding a lien, states:

"Had it been intended that the trustee should take the *status of a creditor holding a lien by legal or equitable process* as of a time anterior to the initiation of the bankruptcy proceeding, it seems reasonable to believe that some expression of that intention would have been embodied in section 47a as amended. As this was not done, we think the better view, and one which accords with other provisions of the act, is that the trustee takes the *status of such a creditor* as of the time when the petition in bankruptcy is filed."

In other words, the trustee takes the status of a creditor holding a lien by legal or equitable process as of the time when the petition in bankruptcy is filed.

It is the law that in states where the mortgages are void only as to creditors extending credit intermediate the execution and recordation of the mortgage, that the chattel mortgage is void as to the trustee because he possesses the rights of the most favored creditor.

In re Johnson, 212 Fed. 315;

In re Farmers' Co-Operative Co., 202 Fed. 1008.

It is not the law, as contended by counsel, that the trustee represents only proven claims, and neither is it necessary to allege or prove the amount of such

proven claims. This subject is separately treated under subdivision "P" of paragraph III in our discussion of preferences.

III.

Assuming That the Four Mortgages Were Not Void Under the Laws of California, They Would Then, Nevertheless, Constitute a Preference Because (A) Under the Law of California They Were Required to Be Recorded, and (B) on the Date of Recordation, Being Within Four Months of the Filing of the Petition, Bankrupt Was Insolvent, and (C) the Bank Had Reasonable Cause to Believe That the Recordation Thereof Would Effect a Preference, and (D) Because the Effect Thereof Would Be to Give to Defendant a Larger Percentage of Its Claim Than Other Creditors of the Same Class.

(A)

A Chattel Mortgage in California Is Required to be Recorded.

The California Code Requires That the Chattel Mortgage Be Recorded.

(Supra, page........). Section 60(b) of the Bankruptcy Act provides that if, at the time of the recording of a transfer—if by law recording is required—and being within four months before the filing of the petition in bankruptcy, the bankrupt be insolvent and the transfer then operate as a preference

and the person receiving it shall then have reasonable cause to believe that the enforcement of such transfer shall operate as a preference, it shall be voidable by the trustee. It is well settled, as heretofore shown, that the chattel mortgages were required to be recorded, within the meaning of this section.

In Carey v. Donohue, 240 U. S. 430, 36 Sup. Ct. Rep. 386, a case arising under the Ohio statute declaring fraudulent an unrecorded deed insofar as relates to subsequent *bona fide* purchasers, without knowledge of the existence of the deed, the Ohio courts having declared thereunder that the failure to record causes no rights to accrue to any one other than the *bona fide* purchaser. The court, in holding that the recording of the deed was not required by law within the meaning of the provisions of the Bankrupt Act, since under the local law the failure to record the deed did not render it invalid as to the grantor's creditors, says:

> "As Congress did not undertake in section 60 to hit all preferential transfers (otherwise valid) merely because they were not disclosed, either by record or possession, more than four months before the bankruptcy proceeding, the inquiry is simply as to the nature of the requirement of recording to which Congress referred. The character of the transfer itself, both with respect to what should constitute a transfer and its preferential effect, had been carefully defined. It is plain that the words are not limited to cases where recording is required for the purpose of giving validity to the transaction as between the parties. For that purpose, no amendment of the original act was needed, as in such a case there could be

no giving of a preference without recording. But in dealing with a transfer, as defined, which, though valid as between the parties, was one which was 'required' to be recorded, the reference was necessarily to a requirement in the interest of others who were in the contemplation of Congress in enacting the provision. *The natural, and, we think, the intended, meaning, was to embrace those cases in which recording was necessary in order to make the transfer valid as against those concerned in the distribution of the insolvent estate; that is, as against creditors, including those whose position the trustee was entitled to take.*"

Inasmuch as chattel mortgages, under the law of California, are required to be recorded and, at least until recorded are invalid as against creditors, the question is whether, on April 23rd, 1915, the date of recording the mortgages, they operated as a preference.

The case of Carey v. Donohue, *supra*, was discussed in Bunch v. Maloney (C. C. A. 8th Cir.), 233 Fed. 967. In that case it appeared that in Arkansas the statute provided that every mortgage shall be a lien on the mortgaged property from the time it is recorded and not before. The Supreme Court of Arkansas had held that a chattel mortgage, though not recorded, was good as against the mortgagor and general creditors. The court says:

"The Supreme Court did not have before it in Carey v. Donohue the question which arises here. Its decision was that a trustee could not, under section 60b, avail himself of a recording requirement exclusively in the interest of some one out-

side the purview of the Bankruptcy Act and for whom he was not authorized to speak. But the language employed in the opinion in that case is broad enough to admit of the assertion of a voidable preference by the trustee as the representative of general creditors, though while without lien they may have been remediless under the local statute, had bankruptcy proceedings not intervened. Thus it was said:

> 'The natural, and we think the intended, meaning was to embrace those cases in which the recording was necessary in order to make the transfer valid as against those concerned in the distribution of the insolvent estate; that is, as against creditors, including those whose position the trustee was entitled to take * * * In the present case there was no requirement of recording in favor of creditors, either general creditors or lien creditors.'

Again:

> 'Rather, as we have said, we deem the reference to be to requirements of registry or record which have been established for the protection of creditors—the persons interested in the bankrupt estate, and in whose behalf, or in whose place, the trustee is entitled to act.'

"The reasonable conclusion is that, where the applicable registry statute provides generally that an unfiled or unrecorded transfer shall be void as to 'creditors,' or employs words of similar import, as in Arkansas, the trustee in bankruptcy, as the representative of general creditors, may invoke the remedy of section 60b, regardless of the local construction of the statute making a procedural

distinction between creditors with a lien and those without."

(B)

On April 23rd, 1915, Bannister Was Admittedly Insolvent.

The testimony is undisputed that Bannister was insolvent both on April 23rd and April 8th, 1915. [Tr. 167, 181, 182, 232.] The mortgages were recorded April 23, 1915. [Tr. 150, 152, 193.] The involuntary petition in bankruptcy was filed May 5, 1915. [Tr. 165.] Bannister scheduled in bankruptcy assets in the amount of $59,157 at his valuation, but he includes in this a claim against the Los Angeles Hay Storage Company in the sum of $17,492—admittedly worthless [Tr. 181-182], and other items are scheduled thousands of dollars in excess of the valuation placed thereon by experts. His liabilities, scheduled at only $46,756, do not include $9,200 of the $10,500 indebtedness to the National Bank of Bakersfield, then existing, and does not include other obligations aggregating $6,302.94. [Tr. 167.] When these deductions and additions are computed on his schedule of assets and liabilities it will readily be seen that Bannister was clearly insolvent.

(C)

The Defendant Had Reasonable Cause to Believe, on April 23, 1915, Before the Recordation of the Mortgages, that the Recordation Thereof Would Effect a Preference in Its Behalf.

Bannister testified that his home had been attached on April 21, 1915. His wife had written him and had told him the home was attached. He says he got ready and probably went to the bank to see Russell, the cashier, or telephoned him that he had to go to Los Angeles right away, that his home had been attached. [Tr. 164.] That when he received the letter from his wife he went to the bank and explained the situation to them. He does not remember what they said, only that they were going to put all that stuff that he had given them on record. [Tr. 131.] He went to the bank just as soon as he was attached. [Tr. 138, 164.]

Russell testified that the bank was to put the mortgage on record if anything happened [Tr. 241]; and Bannister testified that it was up to the bank to put them on record any moment if they thought they were not fully protected. [Tr. 132.] He also testified that on April 23rd, 1915, before recording the chattel mortgages, he met a man on the street who told him that Bannister was in financial trouble. [Tr. 241.] While he did not know what the trouble was, that inasmuch as they had spoken to him about it he went back to the bank, got the mortgages and recorded them, first telling his assistant cashier that he was going to record them and that by recording them, if something should happen he could take possession and protect his money.

[Tr. 241.] When Bannister returned from Los Angeles Russell told him that he had learned that he was in difficulties down there and that he had recorded all the mortgages, to which Bannister responded, "All right, it belongs to you, that was the agreement." [Tr. 241-242.]

At and prior to the recording of the chattel mortgages the Los Angeles Hay Storage Company, of which Bannister was almost the sole owner, was in financial straits [Tr. 141-142-143], and the bank at that time knew that the Los Angeles Hay Storage Company was in trouble with its creditors, and that Bannister was a heavy stockholder therein. [Tr. 133-134.]

On no possible theory could the mortgages have had any existence until their recordation on April 23rd. They could not, therefore, have been called into existence until after Mr. Russell had been informed, on the streets of Bakersfield, that the bankrupt was in financial trouble. He had such notice as put him upon inquiry, and had he followed such inquiry to the end he would have ascertained that the bankrupt was insolvent. It is of no importance that at that time Mr. Russell did not know, as claimed by him, that the bankrupt was insolvent. He knew that Bannister's house had been attached. [Tr. 164-137-131.] He knew that the Los Angeles Hay Storage Company was in financial difficulties with its creditors, and that Bannister was a heavy stockholder therein, and had he made inquiry he could readily have ascertained the insolvency of the bankrupt. [Tr. 133-134-141.]

It is the law that notice of facts which would put a reasonably prudent man upon inquiry is notice of all

the facts which a reasonably diligent inquiry would disclose.

In re Dorr (C. C. A. 9th Cir.), 198 Fed. 293;
R. H. Herron Co. v. Moore (C. C. A., 9th Cir.), 208 Fed. 134;
Coder v. McPherson (C. C. A., 8th Cir.), 152 Fed. 951;
In re State Printing Co. (C. C. A., 7th Cir.), 238 Fed. 775;
Stern v. Paper Co., 183 Fed. 235;
In re Edwards, 217 Fed. 102.

(D)

The Effect of the Chattel Mortgage Is to Give the Defendant a Larger Percentage of Its Claim Than Other Creditors of the Same Class.

The evidence establishes the fact that defendant has received a larger proportion of its claim than other creditors of the same class. It is established by the evidence that on April 23rd, 1915, Bannister was insolvent, while the adjudication of bankruptcy only a short time thereafter was a judicial determination of that fact. Thus it has been established, both by evidence and judicial determination, that Bannister's liabilities exceeded, and exceeds, his assets, but if these mortgages, payment under which have been made to the bank, are to stand, the bank will have been paid in full. Bannister's payments on and subsequent to February 10th, 1915, aggregate $10,681.13 [Tr. 244], while payments subsequent to April 23rd, 1915, aggre-

gated $8,381.13, leaving a balance still due defendant of $488 [Tr. 243], and there remains $555 arising from the sale of the mortgaged automobile [Tr. 233], which is held by the trustee under order of the referee awaiting final determination of this suit. [Tr. 243.] And this sum is more than sufficient to cover said balance of $488.

Furthermore, Mr. Russell testified that the goods claimed to be mortgaged were worth, on April 23rd, 1915, more than they sold for. [Tr. 248.] So that it is clear that these mortgages at the date of their recordation operated to pay defendant in full, and further, since Bannister was insolvent, they operated to give defendant a larger percentage of its claim than other creditors of the same class, to-wit, unsecured creditors.

It is contended, however, that the rule that plaintiff must establish that defendant has obtained a larger percentage of its claim than other creditors of the same class is limited to other creditors who have *proven claims* against the bankrupt estate. In so contending counsel has evidently overlooked the phraseology of the statute.

Those transfers are voidable if, at the time of the recording of the transfer (if by law such recording is required), and being within four months prior to the filing of the petition in bankruptcy, the bankrupt be insolvent and the judgment or transfer *then* operate as a preference, and the person receiving it or to be benefited thereby, shall *then* have reasonable cause to believe that the enforcement of such judgment or transfer would effect a preference, it shall be voidable by the

trustee and he may recover the property or its value from such person.

Section 60b provides:

"If a bankrupt shall have procured or suffered a judgment to be entered against him in favor of any person or have made a transfer of any of his property, and if, at the time of the transfer, or of the entry of the judgment, or of the recording or registering of the transfer if by law recording or registering thereof is required, and being within four months before the filing of the petition in bankruptcy or after the filing thereof and before the adjudication, the bankrupt be insolvent and the judgment or transfer *then* operate as a preference, and the person receiving it or to be benefited thereby, or his agent acting therein, shall then have reasonable cause to believe that the enforcement of such judgment or transfer would effect a preference, it shall be voidable by the trustee and he may recover the property or its value from such person. And for the purpose of such recovery any court of bankruptcy as hereinbefore defined, and any state court which would have had jurisdiction if bankruptcy had not intervened, shall have concurrent jurisdiction."

It is clear, therefore, that in determining what constitutes a preference the elements of a preference must be determined as of the time of the recording of the instruments, and the question is whether, *at the time the mortgages were recorded,* the bankrupt was insolvent, and whether, *at that time,* the defendant bank had reasonable cause to believe that it was obtaining a preference, and whether, at that time, such transfer

operated as a preference by giving to the defendant a larger proportion of its claim than other creditors of the same class, to-wit, other unsecured creditors.

The rule contended for is not only violative of the statute, but also leads to a patent absurdity. Creditors may have, and frequently exercise, a year in which to file claims. Must the trustee, forsooth, delay action to set aside a fraudulent conveyance until all the claims have been filed against the estate? While the trustee is so delaying, the defrauding party may have left the country, or himself have become bankrupt.

Moreover, the authorities cited by counsel do not support his contention, as will readily be perceived by a perusal of them.

It is the law that it is not necessary to either plead or prove that claims have been filed with and allowed by the referee.

The law is well stated in Gering v. Leyda, 186 Fed. 110 (C. C. A., 8th Circuit), where the court says:

> "It is contended in behalf of plaintiffs in error that the trustee's petition failed to state a cause of action entitling him to recover a preference because it is not averred therein that at the time of the commencement of the action *the claims of any creditors had been proved and allowed against the estate of the bankrupt. In our opinion it was not necessary for the trustee to allege and prove that claims of creditors had been filed and allowed against the estate of the bankrupt prior to the commencement of the suit.* The trustee's petition alleged that at the time of the transfer in question the bankrupt 'was hopelessly insolvent, and that his indebtedness amounted to over $24,000,' and that

the only unexempt property then owned by him was the stock of merchandise conveyed to plaintiffs in error, and we are of opinion that these allegations sufficiently charged that at the time of the transfer complained of the bankrupt was indebted to general creditors, who were not secured, and who were entitled to share in the preference recovered. We think the trustee's petition stated a good cause of action, for the recovery of a preference. Swarts v. Fourth Nat. Bank, 117 Fed. 1, 54 C. C. A. 387; Coder v. McPherson, 152 Fed. 951, 82 C. C. A. 99; Wright v. Skinner Mfg. Co., 162 Fed. 315, 89 C. C. A. 23; Tumlin v. Bryan, 165 Fed. 166, 91 C. C. A. 200, 21 L. R. A. (N. S.) 960; *In re* Leech, 171 Fed. 622, 96 C. C. A. 424."

In Coder v. McPherson (C. C. A., 8th Cir.), it is said:

"As Armstrong was insolvent when he gave the mortgages their necessary effect was to enable one of his creditors to obtain a greater percentage of its debt than others of the same class, and they therefore created a preference under section 60a."

In Swarts v. Fourth National Bank, 117 Fed. 3 (C. C. A., 8th Cir.), Judge Sanborn, in delivering the opinion, says:

"No one can become familiar with the bankrupt law of 1898 without a settled conviction that the two dominant purposes of the framers of that act were: (1) The protection and discharge of the bankrupt; and (2) the distribution of the unexempt property which the bankrupt owned four months before the filing of the petition in bankruptcy against him, share and share alike, among

his creditors. All the earlier sections of the act are devoted to the security and relief of the bankrupt, and, when the distribution of his property is reached, the provisions relating to it are all drawn from the standpoint of the insolvent, and not from that of his creditors. The rights and privileges of the bankrupt, and the equal distribution of his property, dominate every provision, while the rights, wrongs, benefits, and injuries of his creditors are always incidental, and secondary to these controlling purposes. Section 60a contains the legal and controlling definition of the preference specified in section 57g and the other parts of the Bankrupt Act. 30 Stat. C. 541, p. 562 Kimball v. E. A. Rosenham Co. (C. C. A.), 114 Fed. 85. 7 Am. Bankr. R. 718, 719; Pirie v. Trust Co., 182 U. S. 438, 21 Sup. Ct. 906, 45 L. Ed. 1171. But this definition of a preference was not written from the station of the creditor, but from that of the debtor. It is not the act of the creditor, but the act of the debtor, which gives it,—which produces it. The controlling thought is not the benefit or injury to the creditor, but the equal distribution of the property of the bankrupt among the holders of the provable claims against him. * * *

"Four months before the filing of the petition in bankruptcy, the bank had a claim against the estate of the insolvent for $60,000. Within that four months, it received $14,600 out of his estate, so that, when the petition in bankruptcy was filed, instead of a claim for $60,000 against the insolvent it held $14,600 of his money, and a claim against him for $45,400. The statement of these facts is itself a demonstration that if the bank can retain this money, and procure the allowance

of the balance of its claim, it will receive a greater percentage of its debt out of the estate of the insolvent than other creditors of the same class who receive no such payments. The insolvent has increased the funds of the bank $14,600, and it has diminished by $14,600 the property to be distributed among its creditors; and it is the depletion of the estate, to pay a larger percentage upon one claim against it than others of the same class will receive, against which the provisions of section 60a and section 57g are specifically leveled. The conclusion is irresistible that the payment to the bank of $14,600 gave it a preference over the other creditors of the bankrupt of the same class."

See also:

Jackman v. Eau Claire Nat. Bank, 125 Wis. 465, 115 Am. St. Rep. 955.

IV.

Defendant's Claim of Equitable Lien Is Without Merit. An Equitable Lien Will Never Be Found in Favor of One Guilty of a Constructive Fraud. It Will Not Be Declared Where the Goods Are Not Identified or Segregated and There Has Been a Commingling and Confusion With Other Goods. Neither Will It Be Declared as Against a Trustee in Bankruptcy Representing Creditors of the Estate Where, by the Provisions of the Bankruptcy Act Itself, the Alleged Lien Is Void.

The chattel mortgages on the stock in trade were, on January 12th, 1915, given entirely to secure antecedent indebtednesses, with the exception only of one note securing the sum of $1500. [Tr. 150.] When Bannister commenced doing business with the defendant bank he had an agreement with Russell, its cashier, to do business as he had been doing with the old Bank of Bakersfield, with which Russell had formerly been connected. [Tr. 235.] The bankrupt had been in the habit of giving chattel mortgages to the old Bank of Bakersfield which were never recorded, and Bannister says that it was the understanding that the mortgages should not be recorded until something should happen. [Tr. 132, 237.] Just before recording the mortgages Russell told his assistant cashier that he purposed recording the mortgages so that if anything should happen he could take possession and protect himself. [Tr. 241.] When Russell told Bannister that he had re-

corded the mortgages, Bannister said, "That is all right; that was the agreement." [Tr. 241, 242.]

The mortgages on the stock in trade, given January 12, 1915, itemized and specified the particular goods mortgaged. [Tr. 151.] Thereafter Bannister conducted his business as usual, sold portions of the mortgaged goods, and purchased other goods in lieu thereof. The goods were coming in and going out all the time. [Tr. pp. 149-150-171-172-177-178-179-188-194-195-205-206-249-252.]

Counsel contends that as goods were sold the money so received, less expenses, was paid to the bank, and that other goods were substituted in lieu of that sold, and that an equitable lien results therefrom. As a matter of fact, as the mortgaged goods were sold by Bannister in the ordinary course of business he used the proceeds thereof in various ways; he paid some of his old debts therefrom, paid labor bills, appropriated some of the money for his personal use, paid a portion thereof to the bank, and used a portion thereof in payment of current bills [Tr. 178, 217, 221 to 229.] Through the purchase of new goods, substituted in lieu of the mortgaged goods sold, the bulk of the property remained the same. [Tr. 179-188-194-195-196-200.] It does not appear, however, that the new goods purchased were paid for, and such could not have been the case if, as contended by counsel, the money received from the sale of the mortgaged goods was paid to the bank. (Appellants' Brief, p. 31.) The result is that through sales of the mortgaged property the indebtedness to the bank was reduced, while the

bulk of the property, consisting of the mortgaged goods and the new goods commingled and confused therewith, remained the same. [Tr. 200.] And now counsel has the temerity to claim an equitable lien upon the remaining property mortgaged, together with the new goods purchased and commingled and confused therewith, notwithstanding that by the transaction the bank has been partially paid, and other creditors have extended credit in the sale of the substituted goods. A lien is claimed, notwithstanding that the result of the transaction would be that the bank's debt has been decreased while its secret security would (in the event the asserted lien is held valid) be increased.

The bank, prior to the recordation of the mortgages on April 23rd, kept the existence of such mortgages a secret from the creditors [Tr. pp. 132-153, 233-241, 245-246], and during all this time the bank knew Bannister's method of conducting his business, knew that he was making sales of merchandise, and knew the condition of his books. [Tr. 245-246.] We contend that no lien, equitable or otherwise, attached to these goods. A lien or chattel mortgage upon property commingled and confused with other property not mortgaged renders the lien or the mortgage invalid. An equitable lien is a creation of equity, and from the very nature of the case cannot exist when the very basis upon which the lien is claimed to rest is tainted with constructive fraud. An equitable lien at best can exist only on designated property,—on property identified and segregated, and can not exist, as in this case, where its identity is lost by reason of its confusion

with other goods. It cannot exist as to creditors where it is required to be recorded and is not recorded, and record thereof is necessary in order to impart notice. *In short, it cannot exist where, by the provisions of the Bankruptcy Act itself, the lien is void.*

The Bankruptcy Act itself prescribes the liens which shall not be affected by the act as being those given for a present consideration "which have been recorded according to law, if record thereof was necessary in order to impart notice."

Section 67d of the Bankruptcy Act provides:

> "Liens given or accepted in good faith and not in contemplation of or in fraud upon this Act, and for a present consideration, which have been recorded according to law, if record thereof was necessary in order to impart notice, shall, to the extent of such present consideration only, not be affected by this Act."

Section 67e of the Act provides, in part:

> "* * * And all conveyances, transfers, or incumbrances of his property made by a debtor at any time within four months prior to the filing of the petition against him, and while insolvent, which are held null and void as against the creditors of such debtor by the laws of the state, territory or district in which such property is situate, shall be deemed null and void under this Act against the creditors of such debtor if he be adjudged a bankrupt, and such property shall pass to the assignee and be by him reclaimed and recovered for the benefit of the creditors of the bankrupt."

The courts have repeatedly held that where a mortgage on a stock in trade is secretly given and withheld from record, and the mortgagor, with the consent and knowledge of the mortgagee, conducts his business as usual and confuses the new goods purchased with the mortgaged goods and pays to the mortgagee the proceeds of the sales of mortgaged goods, that such a mortgage constitutes a fraud on creditors and is invalid.

Scandinavian-American Bank v. Sabin, 227 Fed. 579 (C. C. A., 9th Cir.);
In re Hickerson, 162 Fed. 345;
In re Shaw, 146 Fed. 273;
Rogers v. Page (C. C. A., 6th Cir.), 140 Fed. 596;
Clayton v. Exchange Bank of Macon (C. C. A., 5th Cir.), 121 Fed. 630;
Tysor-Cheatham Mercantile Co., 178 Fed. 733;
Orr v. Park (C. C. A., 5th Cir.), 183 Fed. 683;
In re Duggan, 183 Fed. 405 (C. C. A., 5th Cir.).

In the case of Scandinavian-American Bank v. Sabin, *supra,* it was held that the instrument in question was nothing but a mortgage, and that inasmuch as it permitted a mortgagor to remain in possession and sell goods in the regular course of trade, that it was in fraud of creditors, under the laws of Oregon, the court saying:

> "The rule is one calculated to promote fair dealing between a vendor of personal property and his creditors, or parties who are likely to become

creditors. In the present case there was nothing whatsoever, of record or otherwise, to indicate to any one with whom Sondheim might contract debts that the goods and merchandise on display in his store were incumbered in any manner whatever. It appears from the record that Sondheim purchased merchandise on credit to the value of thousands of dollars, and it is but reasonable to suppose that to a great extent he was enabled to do this by reason of the fact that the parties from whom he purchased looked upon his stock of merchandise as an asset and a source of payment in the event of the failure of Sondheim to meet his obligations. Such, at least, was the inevitable tendency of the situation, without regard to any actual fraudulent intent on the part of either the bank or Sondheim. It would indeed be a harsh rule which would permit the bank, under such circumstances, to retain and enjoy the fruits of a situation brought about by its own unjust and unfair acts and conduct, at the expense of the general creditors of the bankrupt."

In Orr v. Park, *supra*, the court says:

"No inventory or valuation of the stock of goods seems to have been made and furnished to Park, and no special examination of the stock made by him. Dunn Bros. remaining in possession of the goods, continuing business, and selling goods, just as before the mortgage was made; their failure to sign the mortgage and have it witnessed until from one to three months after it purports to have been made; their possession of the mortgage subsequent to their signing it; and the withholding it from record—are badges of fraud which were sufficient, in our opinion, to

> warrant the judgment and finding of the referee that the mortgage was made to hinder, delay and defraud the creditors of said Dunn Bros., and was null and void, in which judgment and finding we concur. Blennerhasset v. Sherman, 105 U. S. 100-118, 26 L. Ed. 1080; Clayton v. Exchange Bank, 121 Fed. 630, 57 C. C. A. 656; Hilliard v. Cagel, 46 Miss. 309."

It is too clear for argument that the transaction in the instant case, being tainted with constructive fraud, from the very nature of the case an equitable lien—a creation of equity—cannot arise therefrom.

Furthermore, it is the law that an equitable lien cannot arise unless the property can be identified and segregated, and that it cannot exist, as in this case, where its identity is lost by reason of its confusion with other goods.

In re Bothe (C. C. A., 8th Cir.), 173 Fed. 597, where the court says:

> "It appears without contradiction that Martin had six wagons of various kinds at the time he executed the mortgage. The only description of those conveyed was 'five wagons.' There was no segregation of any particular five wagons from the larger number owned by Martin, and no means were disclosed, in the mortgage or otherwise, for determining which of them were intended to be conveyed. For want, therefore, of a sufficient description to identify the property intended to be conveyed the mortgage was void as to the wagons."

The case of *In re* Flatland, cited by counsel, involved the validity of a chattel mortgage on property *then and thereafter to be placed within a certain store building.* In other words, the property mortgaged was subject to designation and segregation. It covered everything within the store building. Quite a different situation from the case at bar, where the mortgage covered only specified articles, a portion of which were sold in the ordinary course of business and other goods were substituted in their place, while the proceeds of the goods sold were paid to the bank. Furthermore, neither preferences nor constructive frauds are involved in the Flatland case, and the decision itself has been somewhat moderated in the more recent decisions of this court.

In this case, with the knowledge and implied consent of the bank, the bankrupt deliberately confused the mortgaged goods, and, having been so confused, the bank, after petition in bankruptcy was filed, took possession of all the confused property. That defendant is not entitled to an equitable lien is finally determined, however, by the Fourth Street National Bank v. Millbourne Mills Co.'s Trustee (C. C. A., 3rd Cir.), 172 Fed. 177, and the case of Security Warehousing Company v. Hand, 206 U. S. 415, 27 Sup. Ct. Rep. 720, affirming the opinion of Judge Baker of the Seventh Circuit.

The court, in the case of Fourth Street National Bank v. Millbourne Mills Co.'s Trustee, differentiated the case of Hurley v. A. T. & S. F., 213 U. S. 126, relied upon by counsel, from such a case as the case

at bar. The court, in analyzing the subject of equitable lien, says:

> "But the vital thing lacking, the same as in the case of the grain, was that there was nothing to negative the apparent ownership of the bankrupt company, in whose possession, and under whose control, to all intents and purposes, it was. Without this, it was presumptively, as it was actually, theirs, subject only to such rights as against the company, as the certificate holders might be entitled to assert before the rights of creditors had attached, with which, at this time, we are not concerned. To preserve the rights of such holders, as against creditors, either by way of equitable lien or pledge, it had to be openly and clearly indicated that the flour was theirs, without which the mere storing of it, by itself, in the basement, which in effect was all that was done, was of no avail. Sholes v. Asphalt Company, 183 Pac. 528, 38 Atl. 1029; Barlow v. Fox, 203 Pac. 114, 52 Atl. 57; * * *
>
> "It is, however, contended that, there being an intent to pledge, an equitable lien was at least created, which entitles the certificate holders to the fund. It is difficult to see how a transaction, which, for want of delivery, is ineffective as a pledge, can be pieced out so as to make it hold as something else. There would be little left to the established doctrine with regard to pledges if that was the case; and it is somewhat singular that, in all the litigation, where pledges of personal property have been upset, for want of a delivery, no one should have discovered this easy way out. This is not to say that an equitable lien, under some circumstances, may not exist; but only that

there is nothing to support it here. It never arises or is enforced except against property in the hands of a party to the original transaction out of which it is claimed to grow, or his voluntary representatives, or one who has notice of it and is affected with it as a superior right; within which all the cases cited in support of it will be found to fall. 19 Am. & Eng. Enc. (2nd Ed.) 36. It is not good as against a trustee in bankruptcy, taking title, in the interest of creditors, by operation of law, as is the case here. *In re* Olzendam Company (C. C.), 117 Fed. 179; *In re* Liberty Silk Company (D. C.), 152 Fed. 844; * * *

"The question of equitable lien is met and effectively disposed of by the Court of Appeals of the Seventh Circuit in Security Warehousing Company v. Hand, 143 Fed. 32, 74 C. C. A. 186, affirmed 206 U. S. 415, 27 Sup. Ct. 720, 51 L. Ed. 1117, which cannot be distinguished from the present case. 'The appellant lenders finally assert,' says Baker, J., 'that if they have neither the negotiable receipts of a public warehouseman, nor a pledge through an unequivocal possession by their agent, the security company, nevertheless they have "*equitable liens*" which entitle them to the possession of the property as against the trustee. The trustee succeeds, as of the date of the adjudication, not only to the bankrupt's title and possessory right to the property, but also to the right of the bankrupt's creditors to assert that the title and possessory right as to them is in the bankrupt.' Sections 70a(4) and 70a(5), 70e. * * * Liens that remain undisturbed are those that were good against both the bankrupt and his creditors immediately preceding the adjudication. * * * *The conclusion results not merely from a consideration*

*of the nature of the trustee's succession, but as well from the inhibitions of the act. Section 67a vitiates as liens 'all claims which for want of record or for other reasons' the bankrupt's creditors might have avoided as liens; that is, no secret liens or equities shall prevail against the trustee that were not good against the general unsecured creditors represented by the trustee. Section 67d protects 'liens given or accepted in good faith * * * and for a present consideration, which have been recorded according to law, if record thereof was necessary in order to impart notice.' The liens thus saved are liens, not promises to give liens, not equitable claims, that what ought to have been done shall be considered done, but liens perfected according to law. 'Notice' as well as 'a present consideration' is necessary. If a chattel mortgage be given in good faith and for a present consideration, recording is not obligatory; but the imparting of notice is. Recording is one way; another is actual and continued change of possession.* If a pledge be similarly given, recording is not 'necessary in order to impart notice,' because no provision has been made that a record of the fact shall be notice of the fact; but what is 'necessary in order to impart notice' is the delivery of exclusive and unequivocal possession. We think that section 67d does not change section 67a into the meaning that 'claims, which for want of record or for other reasons' are not good liens as against creditors, are good liens as against the estate if the lender advanced his money without any actual intent to defraud unsecured creditors. He is chargeable with the constructive intent which is attributed to secrecy."

The language of Judge Baker, just quoted, evidently met the approval of the Supreme Court of the United States, for in determining the case they simply remarked:

> "Under the circumstances of this case we are satisfied that there was no valid pledge, *and no equitable lien in favor of the interveners which would take precedence of the title of the trustee by virtue of the special provisions of the Bankruptcy Act.*"

From the foregoing it is therefore clear that if the asserted lien would be void by virtue of any provision of the Bankruptcy Act itself, it could not be valid as an equitable lien.

It is therefore clear that an equitable lien cannot be established in this case, because—

(a) Defendant has been guilty of a constructive fraud;

(b) Because the original mortgaged goods could not have been identified or segregated, and the goods upon which the lien is now sought consisted of a portion of the mortgaged goods, together with other goods commingled therewith; and

(c) Because the rights of third parties intervened, and such lien would not be declared against the trustee in bankruptcy, representing creditors of the estate, since, by the provisions of the Bankruptcy Act itself, the alleged lien is void.

The Court Properly Overruled Objections to the Amendment and Denied Defendant's Application to Dismiss.

The original bill sought to have the mortgages set aside (1) as constituting a preference, (2) as being in fraud of creditors, and (3) as being void because on stock in trade of a merchant and not recorded, but failed to allege that prior to the execution of the mortgages or intermediate their execution and recordation, creditors existed. To correct this error the amendment was filed alleging that unsecured debts were created, both prior to the execution of the mortgage and subsequent to such execution, but prior to recordation thereof. The original bill, however, averred all the necessary elements requisite to constitute a preference. The averment that claims existed prior to the execution of the mortgages and that other unsecured claims were created intermediate their execution and recordation was an allegation of ultimate facts. To have enumerated the creditors would have been to have alleged evidenciary facts. The allegation that claims existed was no more a conclusion of law or fact than would have been an allegation in detail as to the existence of each of the claims. Furthermore, the trustee does not, as claimed by counsel, represent creditors who had established their claims against the bankrupt estate. The trustee represents all creditors whether they have established their claims or not, and must act in the interests of all. It was not necessary to have alleged the amount of proven claims and such allegation, if made, might have been stricken out as immaterial. It

is not true that if the mortgages were void they were void only as to those creditors whose rights arose intermediate the execution and recordation of the mortgages. They were void under state law as to all creditors, and under the bankruptcy law they were void as to all creditors as a preference and as being constructively fraudulent, and being void as to all creditors, and the bankrupt being insolvent, and it appearing that unsecured claims could not have been paid in full, it was unnecessary to detail the names of the creditors or the particular class to which they belonged.

If the mortgages are void only as to one of the creditors, it was void as to the trustee. The Bankruptcy Act entitles the trustee to avoid for the benefit of all creditors any transfer which any creditor might have avoided.

> Section 70e of the Bankruptcy Act;
> Remington on Bankruptcy, Vol. 2, Sec. 1738, and cases cited.

The case of Teague v. Anderson Hardware Company, 161 Fed. 765, cited by counsel, was a suit brought upon a bond given in lieu of a chattel mortgage executed by the bankrupt to the defendant. This is one of the early cases decided prior to the amendment of 1910, and at a time when, under the law, the trustee in bankruptcy did not represent all the creditors. The case did not, as here, involve any question relative to preferences or fraud. Furthermore, the case was decided by the District Court, and the Circuit Court of Appeals for that district has since declared a different rule in *In re* Duggan, 183 Fed. 405, where they hold

that even though the mortgage is void as to only one class of creditors, that it will nevertheless be set aside in a suit by the trustee, stating:

> *"If the mortgage were declared void as to one set of unsecured creditors and valid as to another set of unsecured creditors, it would result in an unequal distribution among creditors of the same class."*

In that case a chattel mortgage had been given by the bankrupt on his stock of goods and withheld from record by the mortgagee under a tacit agreement to do so because of the effect which the record would have on the mortgagor's credit. Such mortgage was declared void in a suit instituted by the trustee to set it aside.

From the rule that if the mortgages are void as to one creditor, they are void as to the trustee, it necessarily follows that in an action brought by the trustee it is not necessary to enumerate in detail the creditors that he represents.

We have already shown that, in reason and under the authorities, it is unnecessary to either allege or prove the amount of proven claims. (*Supra,* page . . .)

The case of *In re* Grainger, cited by counsel, was decided prior to the amendment of 1910, and involved no question as to preference or constructive fraud.

It must be borne in mind that this action is brought to set aside the mortgages upon several grounds. The trustee is certainly representative of all creditors in an action brought to set aside a transfer as being a preference or in fraud of creditors, and, while it may pos-

sibly be that the mortgages were void because not recorded, as against creditors only created between the execution and recordation of the mortgages, yet, if void as to them, it is void as to the trustee, as the trustee occupies the position of the most favored creditor, and the mortgages being void as to such creditor, it is unnecessary to allege the existence of other creditors.

However, assuming, though not conceding appellant's contention, rule 19 of the rules of practice for courts of equity provides that:

> *"The court, at every stage of the proceeding, must disregard any error or defect in the proceedings which does not affect any substantial rights of the parties."*

What has been said herein is equally applicable to defendant's objection to the court's ruling on introduction of testimony. The original bill alleged insolvency, the reasonable cause of defendant to believe that by recording the mortgages it would obtain a preference, and that the effect thereof was to give defendant a larger percentage of its claim than other creditors of the same class.

A-32

In the case A-32, the deed of trust was executed April 8th and recorded April 23, 1915, the same date as the chattel mortgages. The only question not discussed in case B-94 is, whether the bank received a preference by receiving and recording the trust deed. Bannister testified that he was in Los Angeles about

the first of April, at which time it was suggested to him that the Los Angeles Hay Storage Company should go into bankruptcy. [Tr. 129.] Bannister was a very heavy stockholder in that company. Bannister received a letter from Mr. Flory, who had suggested the bankruptcy to him, about April 7th; at that time he was in the bank practically every day. On April 8th Bannister went voluntarily to the bank and told them "they should have what protection he could give them," and explained to the bank that the Hay Storage Company was having trouble with its creditors. The bank knew at the time that Bannister was a stockholder in the Hay Company. [Tr. 133.] It simply knew that the Hay Company was in trouble with its creditors in Los Angeles, and that Bannister was a heavy stockholder in that concern. [Tr. 134.] Defendant, by this knowledge, clearly had cause to believe when Bannister told its officers that they could have what protection he could give them, that the taking of the trust deed would effect a preference, for the bank was then put upon notice of facts which would put a reasonably prudent man upon inquiry, and such notice is notice of all the facts which a reasonably diligent inquiry would have developed. It is admitted that Bannister's assets and liabilities on April 8th were the same as on April 23rd. He was therefore insolvent on April 8th. All the facts in B-94 properly applicable are to be considered in A-32 under stipulation. Therefore, both on April 8th and on April 23rd, a reasonably diligent inquiry would have developed that the taking and recording of the trust deed by the

bank would effect a preference in its behalf. All the rules applicable to pereferences, referred to in our discussion under B-94, are applicable to A-32.

It is proper to add that by stipulation it is agreed that the costs in case A-32 shall follow the main case of B-94.

Respectfully submitted,

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